DISTRIBUTED
NOV 22 78

Supreme Court, U. S.
FILED
NOV 16 1978
MICHAEL RODAK, JR., CLERK

Nos. 77-1652 and 77-1654

In the Supreme Court of the United States

OCTOBER TERM, 1978

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

SHELL OIL COMPANY, ET AL.

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

WADE H. MCCREE, JR.
Solicitor General

STEPHEN R. BARNETT
Deputy Solicitor General

RICHARD A. ALLEN
Assistant to the Solicitor General
Department of Justice
Washington, D.C. 20530

ROBERT R. NORDHAUS
General Counsel

HOWARD E. SHAPIRO
Solicitor

M. FRAZIER KING, JR.
Attorney
Federal Energy Regulatory Commission
Washington, D.C. 20426

INDEX

	Page
Opinions below	2
Jurisdiction	2
Question presented	2
Statutes and regulation involved	3
Statement	3
A. The Natural Gas Act of 1938	4
B. The proceedings before the Commission	6
1. Order No. 539	6
2. Order No. 539-A	8
3. Order No. 539-B	8
C. The decision of the court of appeals	12
D. The Natural Gas Policy Act of 1978	13
Summary of argument	17
Argument:	
The Commission has authority under the Natural Gas Act to require certificated producers to develop and maintain delivery of gas from their dedicated reserves by the standard of a prudent operator	20
A. The service obligation assumed by certificated producers under Section 7 implies a standard of deliverability, which may be enforced by the Commission	20

Page

B. The production or gathering exclusion in Section 1(b) does not foreclose enforcement of deliverability standards based on established concepts of prudent operation 23

C. The Commission's prudent operator standard constitutes a reasonable interpretation of the requirements of the Natural Gas Act, is consistent with state regulatory requirements, and accords with the purposes of the Natural Gas Policy Act of 1978 30

Conclusion 38

Appendix 39

CITATIONS

Cases:

Abbott Laboratories v. *Gardner*, 387 U.S. 136 34
California v. *Southland Royalty Co.*, No. 76-1114 (May 31, 1978) 5, 18, 21
Champlin Refining Co. v. *Corporation Commission of Oklahoma*, 286 U.S. 210.. 32
Chisholm v. *FCC*, 538 F.2d 349 34
Gardner v. *Toilet Goods Association, Inc.*, 387 U.S. 167 34
Interstate Natural Gas Co. v. *FPC*, 331 U.S. 682 ..... 25, 26
Mobil Oil Corp. v. *FPC*, 417 U.S. 283 29
Northern Natural Gas Co. v. *State Corporation Commission of Kansas*, 372 U.S. 84 32

Cases—Continued

Page

Permian Basin Area Rate Cases, 390 U.S. 747 22
Phillips Petroleum Co. v. *Wisconsin*, 347 U.S. 672 .....4, 11, 17, 20, 24, 25, 26
Railroad Commission of Texas v. *Rowan & Nichols Oil Co.*, 310 U.S. 573 32
Sunray Mid-Continent Oil Co. v. *FPC*, 364 U.S. 137 .....5, 6, 11, 12, 17-18, 21
United Gas Improvements Co. v. *Continental Oil Co. (Rayne Field)*, 381 U.S. 392 ..... 27, 28

Statutes and regulations:

Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565 4
Emergency Gas Act of 1977, Section 6, Pub. L. No. 95-2, 91 Stat. 4 15
Natural Gas Act, 15 U.S.C. 717, *et seq.*:
Sections 1-24, 15 U.S.C. 717-717w..... 3
Section 1(b), 15 U.S.C. 717(b)....3, 9, 12, 13, 18, 23, 25, 26
Section 7, 15 U.S.C. 717f 4, 15, 19, 30
Section 7(b), 15 U.S.C. 717f(b)....3, 5, 7, 15, 16, 18, 22
Section 7(c), 15 U.S.C. 717f(c) 3, 4
Section 7(e), 15 U.S.C. 717f(e)....3, 4, 15, 18
Natural Gas Policy Act of 1978, Pub. L. No. 95-621, 92 Stat. 3352:
Section 2(18) 15, 36
Section 2(18)(B)(iii) 21
Sections 101-110 14
Section 101(b)(4)(C) 14
Section 101 (b)(9) 14, 38

Statutes and regulations—Continued

	Page
Section 102	37
Section 102(c)	14, 15
Section 102(c)(1)(c)(iii)	37
Section 103(c)	15
Section 104	14, 38
Section 105	14
Section 105(b)	14
Section 106(a)	14, 38
Section 106(b)	14
Section 107(c)	15
Section 121	14
Section 315	17
Section 601	15
Section 601(a)	15, 36
Section 601(a)(1)(B)	37, 38
Outer Continental Shelf Lands Act, 43 U.S.C. 1331 *et seq.*	9
La. Rev. Stat. Ann. § 30:4 *et seq.* (West 1975)	8
Okla. Stat. Ann. title 52, § 274 (West 1969)	8
Tex. Rev. Civ. Stat. Ann. art. 6049c *et seq.* (Vernon 1962)	8
18 C.F.R. 2.76	33
18 C.F.R. 157.41	3, 10
18 C.F.R. 260.7	16
30 C.F.R. Part 250 *et seq.*	9
43 C.F.R. Part 3300	9

Miscellaneous:

	Page
H.R. Rep. No. 709, 75th Cong., 1st Sess. (1937)	28

Miscellaneous—Continued

	Page
H.R. Conf. Rep. No. 95-1752, 95th Cong. 2d Sess. (1978)	14, 17, 21
Interstate Oil Compact Commission, *A Study of Conservation of Oil and Gas in the United States* (1964)	9
Reserves of Crude Oil, Natural Gas Liquids, and Natural Gas in the United States and Canada as of December 31, 1977, Vol. 32, p. 112 (June 1978)	16
1 H. Williams & C. Meyers, *Oil & Gas Law*, ch. 1 (1977 ed.)	9
5 H. Williams & C. Meyers, *Oil & Gas Law* (1977 ed.)	32

In the Supreme Court of the United States

OCTOBER TERM, 1978

No. 77-1652

FEDERAL ENERGY REGULATORY COMMISSION,
PETITIONER

v.

SHELL OIL COMPANY, ET AL.

No. 77-1654

CONSUMER FEDERATION OF AMERICA,
ENERGY POLICY TASK FORCE,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE FEDERAL ENERGY REGULATORY COMMISSION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-10a) is reported at 566 F.2d 536. The order of the Federal Power Commission (No. 539-B) (Pet. App. 13a-32a) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on January 20, 1978 (Pet. App. 11a-12a). By order of April 11, 1978, Mr. Justice Powell extended the time for filing a petition for a writ of certiorari in No. 77-1652 to May 20, 1978; the petition was filed on May 19, 1978, and was granted on October 2, 1978. By order of April 23, 1978, Mr. Justice Powell extended the time for filing a petition in No. 77-1654 to May 20, 1978, and the petition was filed on that date and was granted on October 2, 1978. The jurisdiction of this Court rests on 28 U.S.C. 1254(1) and Section 19(b) of the Natural Gas Act, 15 U.S.C. 717r(b).

QUESTION PRESENTED

Whether the "production or gathering" exclusion in Section 1(b) of the Natural Gas Act denies the Federal Energy Regulatory Commission authority to require certificated producers of natural gas to "observe the standard of a prudent operator" in developing and maintaining delivery of gas from their dedicated reserves.

STATUTES AND REGULATION INVOLVED

Sections 1(b), 7(b), (c), and (e) of the Natural Gas Act, 15 U.S.C. 717(b), 717f(b), (c), and (e), are set forth as an Appendix to this brief, *infra*, pp. 39-41.

Section 157.41 of the Commission's Rules and Regulations, 18 C.F.R. 157.41, provides:

> On and after July 30, 1976, all certificates of public convenience and necessity for the sale of natural gas for resale in interstate commerce shall be conditioned as follows:
>
> > All persons making jurisdictional sales pursuant to the authority granted by this certificate are hereby given notice that the contractual obligations between the buyer and the seller are incorporated into the certificate obligations, and that the certificate is further conditioned to require that the seller shall observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated hereunder.

STATEMENT

This case concerns the obligation of producers under the Natural Gas Act of 1938, 15 U.S.C. 717-717w, to supply gas in interstate commerce. On November 9, 1978, the Natural Gas Policy Act of 1978 ("NGPA"), Pub. L. No. 95-621, 92 Stat. 3352, was signed into law. The Natural Gas Policy Act alters the obligations of producers with respect to certain future sales of gas in interstate commerce, but, as we

shall explain (see pages 13-17, *infra*), the Natural Gas Act of 1938 will continue for many years to govern the non-price obligations of producers with respect to the overwhelming portion of the very large volumes of gas reserves that are presently dedicated to interstate commerce.

A. The Natural Gas Act of 1938

Under the Natural Gas Act of 1938, as construed by this Court in *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954), all producer sales of natural gas for resale in interstate commerce were subject to the requirements of Section 7 of the Act. A producer seeking to sell natural gas for resale in interstate commerce was required to obtain from the Federal Power Commission,[1] under Section 7(c) of the Act, 15 U.S.C. 717f(c), a certificate of public convenience and necessity. Under Section 7(e) of the Act, 15 U.S.C. 717f(e), the Commission could grant such a certificate only if it found "that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform" to the requirements of the Act and the Commission's rules and regulations, and if it further found that the proposed service "is or will be required by the present or future public convenience and necessity." Section 7(e) also authorized the Commission to attach to the

[1] Pursuant to the Department of Energy Organization Act, Pub. L. No. 95-91, 91 Stat. 565, the functions of the Federal Power Commission relevant to this case were transferred to the Federal Energy Regulatory Commission, effective October 1, 1977. We shall use the term "the Commission" to refer to either body, as the temporal context indicates.

certificate "such reasonable terms and conditions as the public convenience and necessity may require."

Once gas began to flow in interstate commerce from the sources covered by the certificate, that service could not be terminated except in accordance with the abandonment provision of Section 7(b) of the Act, 15 U.S.C. 717f(b). That provision states in pertinent part:

> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such facilities, without the permission and approval of the Commission * * * and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public convenience or necessity permit such abandonment.

Thus, as this Court has held in many cases, a certificate issued by the Commission dedicates to interstate commerce the reserves covered by the certificate, and a producer may not cease the service of supplying gas from those reserves to interstate commerce unless it obtains the Commission's permission for abandonment. It may not abandon that service unilaterally, and neither may it do so pursuant to a contract with its customers or lessors.[2]

[2] See, *e.g.*, *California* v. *Southland Royalty Co.*, No. 76-1114 (May 31, 1978); *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960). As those decisions reflect, the measure of the reserves dedicated by the certificate is usually the gas sale contract filed by the producer along with its certificate

B. The Proceedings Before the Commission

In a series of orders, Nos. 539, 539-A, and 539-B, the Commission has sought to define more specifically the obligation of certificated producers under the Natural Gas Act to deliver gas to their interstate customers from their dedicated reserves. As the Commission put it (Pet. App. 16a), the question it addressed was "what standard or test of deliverability the producer is required to live up to under the provisions of the Natural Gas Act and the rules and regulations of this Commission."

1. *Order No. 539*

In Order No. 539, issued October 14, 1975 (A. 2-14), the Commission noted that questions concerning the deliverability of dedicated reserves and the supply obligations of certificated producers had been raised both in congressional hearings and in the day-to-day administration of the Natural Gas Act (A. 2-3). It therefore undertook to state its policy on these questions in a declaration to be incorporated

---

application. Thus, if Producer A sought a certificate to sell gas to Pipeline B, it would attach the gas sale contract to its proposed certificate, and the contract would typically call for the sale, at a certain price, of all gas produced from specified leases held by the producer. The reserves underlying those leases would thus become dedicated to interstate commerce. And unless the certificate was limited in time, those reserves would remain dedicated until the Commission authorized abandonment, notwithstanding any time limitation in the gas sale contract. See *Sunray, supra.*

into its regulations. This statement said, among other things, that as a condition of their certificates, producers have enforceable obligations under the Natural Gas Act with respect to the deliverability of certificated volumes of natural gas, whether or not such requirements were specifically included in the order granting the certificate (A. 11). The Commission further declared that certificates issued from then on should state a certificated minimum delivery obligation of the producer-seller, which would be derived from the gas sale contract but would disregard any contrary contractual reservations; this obligation would remain in effect until modified by amendment of the certificate (A. 13).

Producer and pipeline interests sought rehearing of Order No. 539. They contended, among other things, that the Commission had promulgated a substantive rule without complying with the rulemaking requirements of the Administrative Procedure Act; that Order No. 539 misinterpreted producer-pipeline contracts and existing certificate obligations, in that neither source provided for delivery obligations in specific quantities; and that the Commission was attempting to control activities excluded from its jurisdiction by the production or gathering exclusion of Section 1(b) of the Natural Gas Act, 15 U.S.C. 717 (b), which provides that the Act "shall not apply * * * to the production or gathering of natural gas" (*e.g.*, A. 16-26, 144-156).

2. *Order No. 539-A*

In Order No. 539-A, issued March 26, 1976 (A. 263-283), the Commission explained that it had only intended to make it clear that deliveries under certificated contracts must be maintained in accordance with the requirements of the contract and the certificate (A. 268-276). Nevertheless, the Commission noted the parties' objection "that gas sales contracts do not contain any deliverability obligations whatsoever" (A. 275). To eliminate uncertainty over certificated requirements, the Commission instituted a formal rulemaking proceeding, and it invited interested persons to address in written comments and oral arguments specific questions concerning delivery obligations (A. 272).

3. *Order No. 539-B*

That rulemaking proceeding produced the order at issue here. Producers argued in the proceeding that gas sale contracts do not require producers to deliver any specific quantity of gas (*e.g.*, A. 20-21, 331-335, 348-349, 374-376). They contended that under the typical contract the production of gas remains in the sole discretion of the producer, subject only to the producer's obligations to operate reasonably and prudently—obligations owed to its lessors under covenants in its lease, and imposed also by state[3] or

[3] See, *e.g.*, La. Rev. Stat. Ann. § 30:4 *et seq.* (West 1975); Okla. Stat. Ann. title 52, § 274 (West 1969); Tex. Rev. Civ. Stat. Ann. art. 6049c *et seq.* (Vernon 1962).

federal[4] conservation requirements.[5] The producers claimed that gas purchasers normally have no contractual remedy for a producer's failure to develop production from acreage subject to a gas sale contract, and that the Commission had no authority to require or enforce any delivery obligation under such contracts; the Commission could only prohibit the total abandonment of service or prevent diversion of dedicated gas to another purchaser (*ibid.*). Any attempt by the Commission to assure continued delivery of dedicated reserves would involve the Commission in the "production or gathering" of natural gas, which Section 1(b) of the Natural Gas Act places

[4] On the Outer Continential Shelf, the requirements are defined by the United States Geological Survey, an agency within the Department of the Interior. See Outer Continental Shelf Lands Act, 43 U.S.C. 1331 *et seq.*; 30 C.F.R. Part 250 *et seq.*; 43 C.F.R. Part 3300; OCS Orders Nos. 1-12, governing oil, gas, and sulfur leases to the Outer Continental Shelf, Gulf of Mexico area, U.S.G.S. Conservation Division, January 1975 (Pet. App. 20a).

[5] The producers took the position that they were already subject to a prudent operator standard derived from state law governing oil and gas leases and from state statutes governing conservation and correlative rights (A. 331-333, 346, 370-372). They also argued that they were constrained by the technology of reservoir engineering, which teaches that reservoir production initially may exceed the capacity of pipelines to transport and market the gas, but gradually declines below pipeline capacity levels. See, *e.g.*, A. 167-170, 123, 346, 352. See generally 1 H. Williams & C. Meyers, *Oil & Gas Law*, ch. 1 (1977 ed.). See also Interstate Oil Compact Commission, *A Study of Conservation of Oil and Gas in the United States* 12-74 (1964). See also discussion *infra*, pages 31, 32-33 and note 19.

beyond its jurisdiction (A. 151-152, 178-184, 187-188, 331, 348-351, 402, 403, 410).

The position taken by pipelines in the proceeding was somewhat different. While they generally agreed with the producers that gas sale contracts do not typically set forth any specific minimum delivery obligations, they asserted that purchasers nevertheless have contractual rights to require producers not to cease deliveries arbitrarily or because of a failure to operate with reasonable prudence (A. 454-455, 462-463).

The Consumer Federation of America took the position that existing certificates set forth specific and enforceable delivery obligations (A. 305, 321, 454-455, 463).

After considering these arguments, the Commission, on July 30, 1976, issued its Order No. 539-B, adopting the policy at issue here. It ruled that existing certificates are subject to an implied requirement, and that new certificates would be expressly conditioned to require, that "the seller shall observe the standard of a prudent operator to develop and maintain deliverability from reserves dedicated [under the certificate]" (Pet. App. 24a; 18 C.F.R. 157.41).

The Commission adopted the "prudent operator" standard, in preference to its earlier concept of "certificated minimum daily delivery obligation," because it found that the latter did not have a generally accepted meaning among producers and pipelines (Pet. App. 14a-15a). In contrast, it found that the standard of a "prudent operator" is well-known in the in-

dustry, and to producers in particular, since it is reflected in lease agreements and in the requirements of state and federal regulatory agencies (*id.* at 19a). The Commission stated: "This standard encompasses the obligations to develop the properties consistent with the performance requirements of lease agreements with mineral owners and/or assignors; all valid rules and regulations of any Federal, state or local government having jurisdiction; and the standard of what a reasonably prudent producer would do with respect to the drilling[,] completion, workover, recompletion or abandonment of wells." *Id.* at 20a.

The Commission observed that some parties to its proceeding had advanced the argument "that a common term in producer-pipeline contracts called the 'sole discretion' clause permits the producer complete control over deliverability to the pipeline" (*id.* at 15a-16a). But the Commission insisted that "its certificate conditions, and the incidents of service which [they] represent[], are superior to any limitations on Commission authority contained in the contract" (*ibid.*).

The Commission rejected the producers' contention that the production or gathering exclusion in Section 1(b) denies it authority to enforce deliverability obligations as a condition to certificates. It reasoned, citing *Phillips Petroleum Co.* v. *Wisconsin*, *supra*, that sales for resale in interstate commerce are outside the production or gathering limitation. Under *Sunray Mid-Continent Oil Co.* v. *FPC*, 364 U.S. 137 (1960), and other decisions, once a contract has been certificated, its

obligations must be performed in accordance with the requirements of the Natural Gas Act. Since each certificated contract is subject to the abandonment provisions of Section 7(b) of the Act, the Commission declared that "[i]f the seller under a certificate is not meeting the delivery obligations of such certificate, there has been either a partial or total abandonment of certificated service which requires Commission approval pursuant to Section 7(b)" (*id.* at 23a).

The Commission found that it had authority "to preserve the integrity of its certification process by conducting an oversight review of an on-going service obligation" (*id.* at 18a). Compliance with delivery obligations was to be enforced by determining whether the natural gas company had acted prudently in the circumstances. Such a standard, the Commission ruled, was implicit in the service obligation incorporated into all existing certificates under *Sunray, supra.* The Commission further concluded that it should adopt a regulation making this "prudent operator" obligation explicit and incorporating it expressly in all future certificates (*id.* at 24a).

C. The Decision of the Court of Appeals

Respondents in No. 77-1652, the Shell Oil Company and other producers of natural gas, petitioned for review of Order No. 539-B, contending that it exceeded the Commission's authority under Section 1(b) of the Natural Gas Act. Petitioners in No. 77-1654, Consumer Federation of America (CFA), also petitioned for review, claiming that the "prudent

operator" standard was inadequate to assure fulfillment of certificated delivery obligations.

Agreeing with the producers, the court of appeals vacated and remanded the order (Pet. App. A).

The court held that establishment of the prudent operator requirement was placed beyond the Commission's jurisdiction by the production or gathering exclusion in Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b). The court reasoned that even though the Commission may enforce producers' service obligations by "preventing producers from ceasing deliveries from fields admittedly capable of continuing production," and even though it may regulate abandonments, the Commission's jurisdiction may not be extended "directly into the physical activities, processes, and facilities of production and development" (*id.* at 7a). In the court's view, Order 539-B was such an extension, and the Order was held invalid because it "clearly is intended to open the door to FERC involvement into forbidden production activities" (*id.* at 8a). Stating that to uphold the order "would all but eliminate the 'production or gathering' exclusion and would allow the FERC to encroach on areas reserved to the states," the court declared the order to be beyond the Commission's jurisdiction (*id.* at 9a).[6]

D. The Natural Gas Policy Act of 1978

On November 9, 1978, the Natural Gas Policy Act of 1978 ("NGPA"), Pub. L. No. 95-621, 92 Stat. 3352

---

[6] Having held that the Commission's order exceeded its jurisdiction, the court did not reach CFA's claim that the order did not go far enough (see *id.* at 10a n.6).

was signed into law. Three principal features of that Act are pertinent to the issues in this case: [7]

1. Under Sections 101-110 of the NGPA, all sales of natural gas after December 1, 1978, will be subject to rate ceilings established by the Act itself, and not (except in certain circumstances) to rates established by the Commission. Section 101(b)(4)(C). The Act establishes different ceiling prices for different categories of gas; it applies to all wellhead sales of gas, whether in interstate or intrastate commerce, including gas sold under existing intrastate contracts (Sections 105 and 106(b)).[8] Under Section 101(b)(9),

[7] Copies of the Act and of the Conference Report, H.R. Conf. Rep. No. 95-1752, 95th Cong., 2d Sess. (1978), are being lodged with the Clerk of the Court.

What follows in the text is a general description of certain features of a complex statute. It constitutes only an initial view, which may be modified by the Commission in the light of further experience and consideration.

[8] In the main, ceiling rates for sales of gas already dedicated to interstate commerce will be based on the Commission's established ceiling rate applicable to the gas involved on April 20, 1977, adjusted upward for inflation. Sections 104, 106(a). The Act specifies ceiling rates for numerous other categories of gas. For example, "new natural gas" (defined in Section 102(c)) will be subject to a ceiling rate of $1.75 per million Btu's, adjusted upward for inflation and a growth factor from April 1977. Section 102(b). Gas sold under existing intrastate contracts will be subject to the rate specified in the contract, but no higher than the "new natural gas" price if the contract price is initially lower than the "new natural gas" price. Section 105(b). The Act's pricing provisions are subject to certain other exceptions and qualifications. The Act also provides for eventual deregulation, after January 1, 1985, of rates for certain categories of gas. Section 121.

the prices specified in the Act are only ceilings, and they do not nullify or supersede lower prices specified in contracts.

2. The NGPA expressly codifies the concept, established by decisions under the Natural Gas Act, of natural gas that is "committed or dedicated" to interstate commerce, and it provides that future sales of gas that was so dedicated before November 8, 1978, will remain subject to the provisions of the Natural Gas Act (save for the Commission's rate-regulating jurisdiction, and with certain categories of gas excepted). Sections 2(18), 601(a) of the NGPA.[9] Future sales of gas from reserves so dedicated will therefore remain subject to the conditions of certificates previously issued under Section 7(e), and to the requirement of Section 7(b) that the service of supplying gas from such reserves may not be abandoned without the Commission's approval.

3. Future sales of gas from reserves that were not dedicated to interstate commerce before November 8, 1978, generally will not be subject to the requirements of the Natural Gas Act. Section 601(a) of the NGPA. Thus, sales of such gas will not require a certificate from the Commission under Section 7 of the

[9] Section 601 of the NGPA excludes certain categories of previously dedicated gas from the Commission's jurisdiction under the Natural Gas Act; among those categories are "high-cost gas," defined in Section 107(c); "new natural gas," defined in Section 102(c); natural gas produced from any "new, onshore production well," defined in Section 103(c); and gas sold under Section 6 of the Emergency Gas Act of 1977, Pub. L. No. 95-2, 91 Stat. 4. See also page 37, note 28, *infra*.

Natural Gas Act, and will not be subject to the abandonment provision of Section 7(b).

The principal issue in this case is whether the Natural Gas Act imposes an obligation on certificate holders, which the Commission has jurisdiction to enforce, that they act as reasonably prudent operators in maintaining deliveries to interstate commerce of gas from dedicated reserves. That issue will continue to be significant for many years with respect to the overwhelming portion of the vast quantity of gas now dedicated to interstate commerce. As of December 31, 1977, approximately 92.6 Tcf (trillion cubic feet) of gas,[10] out of currently estimated total remaining recoverable reserves in the United States of 208.8 Tcf,[11] were covered by certificates issued for interstate sales of natural gas under the Natural Gas Act.[12] The validity of Order 539-B as applied to existing certificates thus remains a question that will affect an enormous quantity of gas for the indefinite future.[13]

[10] Compiled from FERC Form No. 15 (18 C.F.R. 260.7), which is submitted annually by all jurisdictional gas pipeline companies. No firm estimates of the amount of previously dedicated gas that is specifically exempted by the NGPA from the non-price regulation provisions of the Natural Gas Act (see note 9, *supra*) are known to the Commission.

[11] *Reserves of Crude Oil, Natural Gas Liquids, and Natural Gas in the United States and Canada as of December 31, 1977*, Vol. 32, p. 112 (June 1978), prepared by the American Petroleum Institute, American Gas Association and Canadian Petroleum Association.

[12] The annual consumption of gas in the interstate market has varied; in 1977 it was 10.2 Tcf. See note 11, *supra*.

However, that part of Order 539-B that requires the prudent operator standard to be expressly incorporated in new certificates issued by the Commission will have no significance under the Natural Gas Policy Act, since sales of gas from reserves not dedicated on November 8, 1978, will not require certificates from the Commission.[14]

SUMMARY OF ARGUMENT

1. The Commission has authority under the Natural Gas Act to require certificated producers to take reasonable measures to develop and maintain delivery of gas from their dedicated reserves. The authority follows from this Court's decisions, particularly *Phillips Petroleum Co.* v. *Wisconsin, supra; Sunray Mid-*

[13] In enacting the Natural Gas Policy Act, Congress explicitly declined to express a view on the validity of Order No. 539-B as applied to existing certificates. In commenting on Section 315 of the NGPA, which authorizes the Commission to specify the duration of the contracts and to provide for a right of first refusal with respect to certain previously dedicated gas, the Conference Report noted that: "The conferees do not intend anything in this section, or anything in this Act, to prejudge the outcome of *Shell Oil* v. *FERC*, No. 76-3066 (5th Cir. Jan. 30, 1978), currently pending before the Supreme Court on the question of the extent of the Commission's jurisdiction over producer performance standards." (H.R. Conf. Rep. No. 95-1752, 95th Cong., 2d Sess. 111 (1978).

[14] This part of Order 539-B is applicable, however, to certificates issued by the Commission from July 30, 1976 (the date of the Order) to November 8, 1978 (the cut-off date under NGPA).

Continent Oil Co. v. *FPC*, 364 U.S. 137 (1960); and *California* v. *Southland Royalty Co.*, No. 76-1114 (May 31, 1978). Those cases have established that when the Commission issues a certificate under Section 7(e) of the Act, what it certificates is not only a sale, but a continuing obligation to deliver gas from dedicated reserves to interstate commerce until the Commission authorizes abandonment under Section 7(b). Unless the Commission has authority to enforce that obligation, the requirements of the Act are hollow.

2. The court of appeals concluded that the Commission has no such authority because delivery obligations involve a physical process and are therefore placed outside the Commission's jurisdiction by the provision of Section 1(b) that excludes from the application of the Act "the production or gathering of natural gas." The court was wrong. As *Phillips* and other cases establish, the production or gathering exclusion in Section 1(b) was not intended to override that Section's affirmative grant of jurisdiction to the Commission. It was intended to make it clear that the Natural Gas Act does not preempt state regulation of aspects of the natural gas business that are local in character, such as state laws regulating the production or gathering of gas in the interests of conservation, safety, or health. The exclusion was not intended to disable the Commission from enforcing the obligations of the Act whenever those obligations could be said to involve a physical process, such as the delivery of gas.

3. In defining the delivery obligations of certificated producers by the standard of a reasonably prudent operator, the Commission made a reasonable interpretation of the requirements of the Natural Gas Act. The prudent operator standard is a flexible one that gives producers ample latitude while preserving the ultimate authority of the Commission to prevent unauthorized de facto abandonments of certificated service. It is also consistent with legitimate state regulatory requirements. Indeed, it is to be administered with reference to such requirements, and constitutes the very standard under which producers claimed they were required by state law to operate.

Whether producers in fact have incentives to withhold deliveries of dedicated gas is irrelevant to the correctness of the Commission's statement of producers' obligations and to the authority of the Commission to enforce those obligations if necessary. The Commission's order was not based on a finding that producers were withholding gas, but was designed to clarify expressed uncertainties regarding the existence and scope of producers' delivery obligations under the Natural Gas Act. The Commission's proceedings confirmed those uncertainties.

The need for a familiar and workable standard defining producers' delivery obligations will continue for many years under the Natural Gas Policy Act of 1978. Under that Act, the provisions of the Natural Gas Act (including Section 7) will continue to apply, in general, to sales of gas from reserves dedicated before November 8, 1978, and such reserves are a

large part of this country's total estimated reserves. Indeed, the uncertainty of the economic incentives created by the new Act makes it particularly important that the Commission not be disabled from taking action to assure delivery of dedicated reserves if necessary. Moreover, the Commission's ability to enforce delivery obligations with respect to such reserves is consistent with the expectation of Congress, embodied in the Natural Gas Policy Act, that continued supplies of gas from such reserves would serve to mitigate the increase in gas prices to interstate consumers in the early years of the new Act.

ARGUMENT

THE COMMISSION HAS AUTHORITY UNDER THE NATURAL GAS ACT TO REQUIRE CERTIFICATED PRODUCERS TO DEVELOP AND MAINTAIN DELIVERY OF GAS FROM THEIR DEDICATED RESERVES BY THE STANDARD OF A PRUDENT OPERATOR

A. The Service Obligation Assumed by Certificated Producers Under Section 7 Implies a Standard of Deliverability, Which May Be Enforced By The Commission.

It is well established under the Natural Gas Act that the Commission's jurisdiction extends to producers who sell natural gas for resale in interstate commerce. *Phillips Petroleum Co.* v. *Wisconsin*, 347 U.S. 672 (1954). It is also well established that a producer (or any other certificated natural gas company) has an obligation under the Natural Gas Act to continue the service of delivering gas from the dedicated reserves

to the certificated purchaser until the Commission, under Section 7(b) of the Act, permits abandonment of that service. *Sunray Mid-Continent Oil Co.* v. *FPC*, *supra*; *California* v. *Southland Royalty Co.*, *supra*. This obligation is superior to any contractual obligation the producer may have. *Sunray*, *supra*, 364 U.S. at 155-156; *Southland*, *supra*, slip op. 6.[15]

In short, under this Court's cases, what is certificated under the Natural Gas Act is not simply a sale, but a continuing obligation to deliver gas from dedicated reserves to interstate commerce.

The Commission's ability to ensure that producers (and other certificated sellers) continue deliveries from dedicated reserves follows, we submit, from the requirements of the Natural Gas Act and the Commission's jurisdiction to enforce those requirements.

---

[15] In Section 2(18)(B)(iii) of the Natural Gas Policy Act, Congress has provided a retrospective exemption from the rule of the *Southland* case by excluding from the definition of gas "committed or dedicated to interstate commerce" gas that has been dedicated by a lessee of acreage which reverted to the lessor on or before May 31, 1978, and from which no gas was flowing in interstate commerce on that date. But the principle and the holding of *Southland* were not rejected. On the contrary, the holding is incorporated in Section 2(18)'s definition of gas "committed or dedicated to interstate commerce" and thus it applies to gas covered by existing certificates, with the exclusion in 2(18)(B)(iii) limited to gas that was not subject to a certificate on May 31, 1978. (The Conference Report states that the exclusion "limits further extension of the holding of the Supreme Court in *California et al.* v. *Southland Royalty Co. et al.* * * *. The case is not, however, reversed on its facts." H.R. Conf. Rep. No. 95-1752, *supra*, at 71 (citation omitted); see *id.* at 71-72.)

If a certificated producer unreasonably shuts in its wells or otherwise unreasonably reduces production; or fails to take prudent steps to maintain its equipment, so that production and delivery cease through simple neglect; or fails to develop its dedicated properties in accord with the requirements of its leases and applicable state law, it has effectively abandoned service without the Commission's approval. The Commission must have power to prohibit such acts or omissions, else the requirements of the Act, and Section 7(b) in particular, would be meaningless. Unless the Commission can define and control delivery obligations, producers would be able, through their dominion over physical operations, to determine for themselves whether and when to undertake a partial abandonment of services by suspending production. As this Court said in the *Permian Basin Area Rate Cases*, 390 U.S. 747, 777 (1968): "'[C]onsiderations of feasibility and practicality are certainly germane' * * *. We cannot, in these circumstances, conclude that Congress has given authority inadequate to achieve with reasonable effectiveness the purposes for which it has acted." On the contrary, "[t]his Court has repeatedly held that the width of administrative authority must be measured in part by the purposes for which it was conferred." *Id.* at 776.

B. The Production Or Gathering Exclusion In Section 1(b) Does Not Foreclose Enforcement of Deliverability Standards Based on Established Concepts of Prudent Operation.

Respondents nevertheless contend, and the court of appeals agreed, that the Commission has no power to enforce producers' delivery obligations under the Act because the delivery of gas involves a physical process and is therefore part of the "production or gathering of natural gas," to which Section 1(b) states that the Act does not apply. Thus, the court declared that to uphold Order No. 539-B "would all but eliminate the 'production or gathering' exclusion" (Pet. App. 9a). There is no merit to this position, which, if sustained, would seriously impair the Commission's ability to carry out its continuing responsibilities under the Natural Gas Act.

The court of appeals was wrong in considering the production or gathering exclusion apart from the affirmative grant of jurisdiction in Section 1(b), and in assuming that the exclusion was intended by Congress to override what would otherwise be an affirmative grant of jurisdiction.[16] The intended relationship

---

[16] Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b), reads in full:

> (b) Transactions to which provisions of chapter applicable
>
> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall

between the affirmative and negative branches of Section 1(b) was considered by this Court in the *Phillips* case, *supra*, 347 U.S. at 679 n.7. The Court there described and quoted the Committee Reports on the Natural Gas Act:

> The committee reports on the bill enacted as the Natural Gas Act, H. R. 6588, 75th Cong., 1st Sess., reveal that a construction of the "production or gathering" exemption which would substantially limit the affirmative grant of jurisdiction to the Commission was not contemplated. After quoting the exemptive clause of 1(b), the House Report states that:
>
> > "The quoted words are not actually necessary, as the matters specified therein could not be said fairly to be covered by the language affirmatively stating the jurisdiction of the Commision, but similar language was in previous bills, and, rather than invite the contention, however unfounded, that the elimination of the negative language would broaden the scope of the act, the committee has included it in this bill." H. R. Rep. No. 709, 75th Cong., 1st Sess. 3.
>
> The Senate Report adopted and reprinted the House Report on the bill. S. Rep. No. 1162, 75th Cong., 1st Sess.

Thus, the production or gathering exclusion was not intended to "substantially limit the affirmative

---

not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

grant of jurisdiction to the Commission," and the exclusions in Section 1(b) were considered superfluous because the matters they specified were not within the terms of the affirmative grants. The relevant and complete inquiry here, then, is whether the Commission's action came within one of the affirmative grants of jurisdiction. If it did, the inference is that it was not within one of the exclusions. So if the Commission's jurisdiction over transportation and sales for resale in interstate commerce includes an ability to ensure that certificated producers continue deliveries from their dedicated reserves, as we have argued in Part A, *supra*, this ability is not destroyed by the production or gathering exclusion.[17]

Moreover, when there does appear to be an overlap between the affirmative grant of jurisdiction in Section 1(b) and the production or gathering exclusion, this Court has made clear how the apparent conflict should be resolved, and why. In *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682 (1947), where sales found to be in interstate commerce were claimed to fall within the production or gathering exclusion, the Court posited that "[e]xceptions to the primary grant

---

[17] Since the court of appeals conceded that the Commission "can enforce 'service obligations' contained in the certificates that it issues to producers, preventing producers from ceasing deliveries from fields admittedly capable of continuing production" (Pet. App. 7a), that should have been the end of the inquiry. The court erred—and disregarded what this Court said in *Phillips*, *supra*, 347 U.S. at 679 n.7, quoted at page 24, *supra*—by going on to hold that, nevertheless, the conceded jurisdiction was substantially curtailed by the production or gathering exclusion.

of jurisdiction in the section are to be strictly construed" (*id.* at 690-691). The Court went on to hold that since the sales were in interstate commerce, "[i]t cannot be doubted that their regulation is predominantly a matter of national, as contrasted to local concern," and that accordingly they were within the Commission's jurisdiction (*id.* at 692-693). As the Court subsequently explained, in deciding the *Interstate* case it "refused to rely on such refinements" as the claim that the gathering of the gas had already been completed at the time of the transportation or sale, but rather "based its decision in *Interstate* on the broader ground that sales in interstate commerce for resale by producers to interstate pipeline companies do not come within the 'production or gathering' exemption." *Phillips, supra*, 347 U.S. at 680-681.

In the *Phillips* case itself, where the Court held that wellhead sales by producers for resale in interstate commerce were subject to the Commission's jurisdiction, it rejected the claim that such sales were excluded by Section 1(b) because they were assertedly "an integral part" of the business of producing or gathering gas. 347 U.S. at 681. The Court quoted its statement in *Interstate* that " '[e]xceptions to the primary grant of jurisdiction * * * are to be strictly construed,' " and further noted, as mentioned earlier, that the Committee Reports on the Act "reveal that a construction of the 'production or gathering' exemption which would substantially limit the affirmative grant of jurisdiction to the Commission was not contemplated." *Id.* at 679 & n.7.

The Court applied the same principles in *United Gas Improvement Co.* v. *Continental Oil Co. (Rayne Field)*, 381 U.S. 392 (1965). In holding there that the Commission had jurisdiction over sales of gas still in the ground (that is, sales of leaseholds), the Court rejected the argument that the timing of those sales (before the gas was "produced") placed them within the production or gathering exclusion and hence beyond the Commission's jurisdiction. The Court stated (381 U.S. at 402):

> Acceptance of any such narrow interpretation would make *Phillips* a shadow. Its substance lies, instead, in the judgment that "[p]rotection of consumers against exploitation at the hands of natural-gas companies was the primary aim of the Natural Gas Act," [347 U.S.] at 685, and "congressional intent [was] to give the Commission jurisdiction over the rates of all wholesales of natural gas in interstate commerce." *Id.*, at 682.

The Court thus held (381 U.S. at 402):

> We conclude that even though a sale of natural gas in interstate commerce occurs before production or gathering is ended, it is nonetheless subject to regulation.

The Court went on to explain (*id.* at 402-403):

> In the context of such a sale, * * * the "production or gathering" exemption relates to the physical activities, processes and facilities of production or gathering, but not to sales of the kind affirmatively subjected to Commission jurisdic-

> tion. This accommodation of the two relevant clauses of § 1(b) gives content to the national objectives of the Natural Gas Act as expounded in *Phillips*, and to the Commission's jurisdiction to accomplish them, while in no way interfering with state regulatory power over the physical processes of production or gathering in furtherance of conservation or other legitimate state concerns.

Thus, as interpreted by the Court in *Rayne Field*, the production or gathering exclusion was intended to save state regulatory power over the physical processes of production or gathering for the purposes of conservation or other legitimate state concerns, but not to limit the Commission's power to enforce the requirements and secure the "national objectives" of the Act. The exclusion does not relate "to sales of the kind affirmatively subjected to Commission jurisdiction" (*ibid.*).

The same principle is reflected elsewhere in the legislative history of the Act. Thus, the report of the House Committee on Interstate and Foreign Commerce on the bill that became the Natural Gas Act (H.R. Rep. No. 709, 75th Cong., 1st Sess. 1-2 (1937)) stated:

> [I]n the case of sales for resale, or so-called wholesale sales, in interstate commerce (for example, sales by producing companies to distributing companies) the legal situation is different. Such transactions have been considered to be not local in character and, even in the absence of Congressional action, not subject to State regulation. (See *Missouri* v. *Kansas Gas Co.* (1924), 265 U.S. 298, and *Public Utilities Commission* v. *Attleboro Steam & Electric Co.* (1927) 273 U.S. 83.) The basic purpose of the present legislation is to occupy this field in which the Supreme Court has held that the States may not act.

In sum, this Court's decisions and the legislative history establish that Congress' purpose in the Natural Gas Act "was to take over where the States' power ceased, following the chain of distribution back to the interstate market * * *. But, once begun, prevention of the circumvention of such regulation virtually compelled extension of control to the source." *Mobil Oil Corp.* v. *FPC*, 417 U.S. 283, 302 n.23 (1974). The production or gathering exclusion was designed to make clear that the Natural Gas Act was not intended to preempt state regulation of activities essentially "local in character"—regulation in furtherance of such traditional state concerns as conservation or health and safety. It was not intended to disable the Commission from enforcing the obligations of the Act whenever those obligations could be said to involve some physical process, such as the delivery of gas.

The exclusion did not have the mechanistic purpose of dividing federal and state jurisdiction on the basis of whether an act or transaction involved some physical process. Rather it had the functional purpose, grounded at once in the "national objectives" of the Act and in considerations of federalism, of saving traditional state jurisdiction over matters that are

"local in character" and that do not impinge on the jurisdiction necessarily given the Commission.

To conclude, as the court of appeals did, that the Commission has no power to enforce the statutory obligations of producers to continue the service of delivering gas from dedicated reserves, because those obligations touch on the physical production process, would indeed "make a shadow" of *Phillips*, as well as other decisions of this Court and Section 7 of the Act. The production or gathering exclusion works no such eviscerating result.

C. The Commission's Prudent Operator Standard Constitutes A Reasonable Interpretation of the Requirements of the Natural Gas Act, Is Consistent with State Regulatory Requirements, and Accords with the Purposes of the Natural Gas Policy Act of 1978.

The court of appeals held that the Commission has no jurisdiction to require producers to comply with the prudent operator standard in delivering gas from dedicated reserves—or, presumably, with any other standard—because such delivery involves the physical process of production. The court therefore did not consider whether the prudent operator standard was substantively consistent with the purposes of the Natural Gas Act. Respondents, however, have argued that the prudent operator standard is not reasonable and will place the Commission in conflict with state regulatory authorities. We therefore will briefly address those contentions.

The prudent operator standard is reasonable. In Order No. 539-B the Commission accepted the producers' claim that it would be impracticable to utilize specific quantitative delivery requirements (Pet. App. 14a-15a). Instead, the Commission adopted a flexible standard giving producers reasonable latitude while preserving the ultimate authority of the Commission to prevent unauthorized de facto abandonments of certificated service.

Far from conflicting with legitimate state regulatory requirements, the prudent operator standard expressly encompasses those requirements and constitutes the very standard under which the producers claimed they were already operating.[18] Thus, the Commission stated (Pet. App. 20a; footnote omitted):

> This standard encompasses the obligations to develop the properties consistent with the performance requirements of lease agreements with mineral owners and/or assignors; all valid rules and regulations of any Federal, state or local government having jurisdiction; and the standard of what a reasonably prudent producer would do with respect to the drilling[,] completion, workover, recompletion or abandonment of wells.

---

[18] See Shell Br. In Opp. at 6: "Producers have long recognized their obligation to develop and produce their leases in a diligent manner, and in accordance with what is described as the 'ordinary prudent operator' test." See also A. 24, 126-128, 145-148, 152-153, 155, 289-301, 331, 343, 346, 354, 401-404.

This standard does not imply federal obligations different from those imposed by the states either under the terms of leases or under state conservation laws. On the contrary, it is to be administered with reference to those state standards. The Commission's standard simply requires that the producer operate in accordance with established practice and with requirements adopted by the jurisdiction exercising direct regulation over the production.[19] Application of

[19] As this Court has stated, oil and gas production "touch-[es] matters of geography and geology and physics and engineering." *Railroad Commission of Texas* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573, 583 (1940). See also *Champlin Refining Co.* v. *Corporation Commission of Oklahoma*, 286 U.S. 210, 228 (1932). Most producing states have enacted conservation laws to regulate the correlative rights of leaseholders through unitization of reservoirs, well spacing requirements, allocation of production through proration systems that determine the amount of oil or gas each well will be allowed to produce, and requirements governing the ratios between gas, oil, and water that determine the pressures by which gas and oil can be forced to the surface through a well. Such measures have been sustained on the ground that the state may constitutionally conserve scarce resources and prevent unfair and discriminatory production by some wells at the expense of others. *E.g. Champlin Refining Co., supra; Northern Natural Gas Co.* v. *State Corporation Commission of Kansas*, 372 U.S. 84, 103 (Harlan, J., dissenting) (1963).

In addition, mineral leases have been held by state courts to imply certain covenants, including covenants to take reasonable measures to develop the premises, to market the product, and to conduct with reasonable care and due diligence all operations on the leasehold that affect the lessor's royalty interest. These implied covenants are the elements of what has customarily been described in the industry as the prudent operator standard. The cases and authorities are collected in 5 H. Williams & C. Meyers, *supra*, at Sections 804, 806-808.

the prudent operator standard to particular cases will depend on the circumstances, but state law or United States Geological Service regulations will ordinarily provide the specific contents of the standard and hence the yardstick against which the producer's performance is measured.

Application of the prudent operator standard to particular cases is not at issue here.[20] What is at issue is simply the Commission's authority to adopt this standard, or any other, to define and enforce the obligation of producers under the Act to operate their facilities so as to deliver the gas they committed themselves to deliver when they obtained a certificate from the Commission.

[20] A spectrum of cases can be posited. At one end is the producer that temporarily shuts in its wells in the hope that higher gas prices will be obtained later, or that deliberately fails to maintain its production facilities properly and then claims it is unable to honor its delivery obligations. At the other end may be cases in which production can be maintained only by drilling additional wells or by taking affirmative measures to maintain pressure in the reservoir. In determining what is prudent, cases of the latter sort would be judged by reference to state or U.S.G.S. production requirements, as Order No. 539-B indicates (Pet. App. 20a).

Application of the prudent operator standard may also require in certain cases a balancing of the costs of affirmative measures against the service obligation in the light of applicable regulatory price ceilings. The Commission confronted this problem in connection with the area and national rate ceilings it developed under the Natural Gas Act. See Policy With Respect To Rates Where Reduced Pressures, Need For Reconditioning, Deeper Drilling, Or Other Factors Make Further Production Uneconomical At Existing Prices (18 C.F.R. 2.76).

Respondents have also argued that the Commission's prudent operator standard is based on the incorrect premise that producers have an incentive to reduce or cease production and delivery of dedicated gas. Respondents claim that considerations of geology and economics provide ample incentives for producers to maintain production and delivery, and that state laws already require them to do so prudently.[21]

This argument is beside the point. Order No. 539-B was based not on a finding that producers had been withholding deliveries of dedicated gas, but on the Commission's interpretation of the Act.[22] Respondents' argument asserts only that the Commission's statement of what the Act requires of producers is, as a practical matter, unnecessary, because producers have other reasons for complying with those requirements. The argument does not show that the Commission's statement of the law is incorrect, as the court of appeals held it to be.[23]

Moreover, the Commission did have reasonable grounds for believing that a statement of producers' delivery obligations under the Natural Gas Act was needed. As we noted earlier (page 6, *supra*), the

[21] See Shell Br. in Opp. at 3-4.

[22] See *Abbott Laboratories* v. *Gardner*, 387 U.S. 136, 149 (1967); *Gardner* v. *Toilet Goods Association, Inc.*, 387 U.S. 167, 170-171 (1967); *Chisholm* v. *FCC*, 538 F.2d 349 (D.C. Cir. 1976), cert. denied, 429 U.S. 890 (1976).

[23] If Order No. 539-B is unnecessary, the Commission happily will not be called on to enforce it, and producers—including the 34 producers who are respondents in this case—will not have been adversely affected by it.

very reason the Commission instituted these proceedings was to resolve uncertainties that had arisen, and the proceedings themselves only highlighted the wide differences of opinion on the subject. Some producers insisted that under their certificated gas sales contracts they had no obligation that could be enforced by their purchasers, or the Commission, to deliver any gas whatever—*i.e.*, that they could terminate deliveries at will.[24] Other producers took a possibly different view,[25] and the position of the pipelines differed further.[26] Other parties, such as the Consumer Federation of America, insisted that the producers

[24] Thus, for example, counsel representing Tenneco and certain other producers asserted that under typical gas sales contracts, producers had no obligation that could be enforced by the purchasing pipeline or the Commission to deliver any amount of gas (A. 408-409, 432-433). He asserted that producers may have obligations to their lessors under lease provisions and state law to operate prudently, but that only the lessors could legally enforce those obligations (*ibid.*).

[25] Counsel representing Shell and certain other producers appeared to agree with the position stated by counsel for Tenneco (A. 408-409); but he also stated (A. 399):

> I think * * * the producers have a delivery obligation under their contracts, and that obligation is to deliver the gas from the field or reservoir committed to that contract.
>
> But the rate of delivery is something else again.

[26] The counsel for an association of pipelines asserted that gas sale contracts did not set forth any specific daily minimum delivery obligation, but that pipeline purchasers and the Commission did have a right to enforce deliveries if the producer was not operating prudently (A. 454-455; see also A. 463).

were obliged to maintain daily deliveries of specific volumes of gas.[27] The Commission's eventual statement of policy and accompanying rule were designed to resolve those questions by providing a workable, familiar, and understandable criterion for delivery requirements under both existing and future certificates.

The need for such a standard with respect to existing certificates will continue for many years under the Natural Gas Policy Act of 1978. As noted earlier (pages 15-17, *supra*), Section 2(18) 601(a) of the Act show that the Natural Gas Act (including Section 7) will continue to apply to future sales of gas from reserves previously dedicated, and such gas constitutes a substantial portion of estimated United States reserves.

Whatever financial incentives to reduce or terminate interstate deliveries may have been generated by the price regulating mechanisms of the Natural Gas Act (see Pet. 10) are likely to be changed, it is true, by the extension of price regulation to the intrastate market under the Natural Gas Policy Act (see page 14, *supra*). But the provisions of the NGPA may provide their own incentives. Producers may believe that gas from dedicated acreage, if withheld from delivery under existing contracts, may qualify for higher prices under one of the price cate-

[27] The Consumer Federation of America contended that certificated contracts set forth a specific, quantitative delivery obligation, measured by the producer's history of deliveries, that could be enforced by the Commission and the purchasers (A. 416-422).

gories of the NGPA.[28] It is difficult to predict precisely what economic incentives producers will have under the NGPA. But whatever they may be, and precisely because of the uncertainties ushered in by the new Act, confirmation of the Commission's ability to establish and enforce a delivery standard for dedicated gas is important. It will ensure that the Commission has power to enforce delivery obligations in any situation where this may prove to be necessary. The decision of the court of appeals, on the other hand, deprives the Commission of such authority in a sweeping and absolute manner.

The Commission's ability to enforce delivery standards is also important to other objectives of the Natural Gas Policy Act. For instance, the NGPA is expected to make available to interstate pipelines sub-

[28] Several provisions of the Natural Gas Policy Act reflect congressional awareness of possible incentives to withhold gas from interstate commitments in the hope of selling it under legislative classifications permitting higher prices. Thus, with respect to gas qualifying as "new natural gas" as defined in Section 102 of the Act, Congress has provided an exclusion for "withheld gas," *i.e.*, gas produced through an old well or gas for which suitable facilities for production and delivery to a pipeline were in existence on April 20, 1977. Section 102(C)(1)(c)(iii) of the NGPA. Although "new natural gas" previously dedicated to interstate commerce will be removed from the Commission's jurisdiction under Section 1(b) of the Natural Gas Act by Section 601(a)(1)(B) of the NGPA, "withheld gas" will remain subject to that jurisdiction. Similarly, the "behind-the-pipe" exclusion in Section 102 denies "new natural gas" treatment to production from reservoirs penetrated by old wells prior to April 20, 1977, from which gas or oil could have been produced in commercial quantities. Section 102(c)(1)(C)(ii).

stantial volumes of additional gas, but at higher prices than those prevailing under presently certified contracts. To mitigate the price increases, the structure of the Act is designed to allow interstate pipelines to continue to rely on presently certificated contracts during the next few years. See Sections 101 (b)(9), 104, 106(a), and 601(a)(1)(B). The assurance of this congressional purpose requires that existing certificate obligations be made effective by a meaningful delivery standard.

CONCLUSION

For the foregoing reasons, the judgment of the court of appeals should be reversed.

Respectfully submitted.

WADE H. MCCREE, JR.
Solicitor General

STEPHEN R. BARNETT
Deputy Solicitor General

RICHARD A. ALLEN
Assistant to the Solicitor General

ROBERT R. NORDHAUS
General Counsel

HOWARD E. SHAPIRO
Solicitor

M. FRAZIER KING, JR.
Attorney
Federal Energy Regulatory Commission

NOVEMBER 1978

APPENDIX

Section 1(b) of the Natural Gas Act, 15 U.S.C. 717(b) provides:

> (b) Transactions to which provisions of chapter applicable
>
> The provisions of this chapter shall apply to the transportation of natural gas in interstate commerce, tot he sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or tot he local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b) provides:

> (b) Abandonment of facilities or services; approval of Commission
>
> No natural-gas company shall abandon all or any portion of its facilities subject to the jurisdiction of the Commission, or any service rendered by means of such faciilties, without the permission and approval of the Commission first had and obtained, after due hearing, and a finding by the Commission that the available supply of natural gas is depleted to the extent that the continuance of service is unwarranted, or that the present or future public covnenience or necessity permit such abandonment.

Section 7(c) of the Natural Gas Act, 15 U.S.C. 717f(c) provides in pertinent part:

> (c) Certificate of public convenience and necessity
>
> No natural-gas company or person which will be a natural-gas company upon completion of any proposed construction or extension shall engage in the transportation or sale of natural gas, subject to the jurisdiction of the Commission, or undertake the construction or extension of any facilities therefor, or acquire or operate any such facilities or extensions thereof, unless there is in force with respect to such natural-gas company a certificate of public convenience and necessity issued by the Commission authorizing such acts or operations: * * *

* * * * *

Section 7(e) of the Natural Gas Act, 15 U.S.C. 717f(e) provides:

> (e) Granting of certificate of public convenience and necessity
>
> Except in the cases governed by the provisos contained in subsection (c) of this section, a certificate shall be issued to any qualified applicant therefor, authorizing the whole or any part of the operation, sale, service, construction, extension, or acquisition covered by the application, if it is found that the applicant is able and willing properly to do the acts and to perform the service proposed and to conform to the provisions of this chapter and the requirements, rules, and regulations of the Commission thereunder, and that the proposed service, sale, operation, con-

> struction, extension, or acquisition, to the extent authorized by the certificate, is or will be required by the present or future public convenience and necessity; otherwise such application shall be denied. The Commission shall have the power to attach to the issuance of the certificate and to the exercise of the rights granted thereunder such reasonable terms and conditions as the public convenience and necessity may require.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1970 278279 184